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In the Supreme Court

OF THE

United States

OCTOBER TERM, 1981

BAXTER RICE, Director,
Department of Alcoholic Beverage Control
of the State of California,
Petitioner,

vs.

NORMAN WILLIAMS COMPANY, et al.,
Respondents.

BOHEMIAN DISTRIBUTING COMPANY,
Petitioner,

vs.

NORMAN WILLIAMS COMPANY, et al.,
Respondents.

WINE & SPIRITS WHOLESALERS OF CALIFORNIA,
a California corporation,
Petitioner,

vs.

NORMAN WILLIAMS COMPANY, et al.,
Respondent.

On Petition for Writ of Certiorari to the Court of Appeal of the State of California, Third Appellate District

CONSOLIDATED BRIEF OF RESPONDENTS

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QUESTIONS PRESENTED

1. Is it lawful for a manufacturer to prevent interstate commerce in goods which he has sold *without restriction*?

2. Should this Court reverse a California state court decision invalidating a California statute, where that decision was based on a finding that California had no regulatory interest in the statute?

3. May a state rely upon the Twenty-first Amendment to authorize unsupervised private conduct which constitutes a per se violation of the Sherman Act?

4. Does the "state action" exemption to the Sherman Act insulate from preemption a California statute which, without any state review or supervision, allows private distilling companies to exclude wholesalers from commerce?

5. Is A.B. 499 preempted by the Federal Alcohol Administration Act?

6. Does A.B. 499 deprive a state-licensed liquor importer of due process by empowering a private party to nullify the importer's license without regulatory standards, a hearing, review or appeal?

7. Does A.B. 499 deprive state-licensed liquor importers of equal protection of the law by conferring the privilege of importing only on those importers who obtain the consent of a private party?

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CONSTITUTIONAL AND STATUTORY PROVISIONS

In addition to the provisions cited by Petitioners, this case involves the following:

U.S. CONST. amend. XIV, § 1:

> "No State shall . . . deprive any person of life, liberty, or property, without due process of law; nor deny to any person within its jurisdiction the equal protection of the laws."

Federal Alcohol Administration Act § 5, 27 U.S.C. § 205:

> "It shall be unlawful for any person engaged in business as a distiller, brewer, rectifier, blender, or other producer, or as an importer or wholesalers of distilled spirits, wine or malt beverages, or as a bottler, or warehouseman and bottler, or [sic] distilled spirits, directly or indirectly or through an affiliate:
>
> (a) *Exclusive outlet.* To require by agreement or otherwise, that any retailer engaged in the sale of distilled spirits, wine or malt beverages, purchase any such products from such person to the exclusion in whole or in part of distilled spirits, wine or malt beverages sold or offered for sale by other persons in interstate or foreign commerce, if such requirement is made in the course of interstate or foreign commerce, or if such person engages in such practice to such an extent as substantially to restrain or prevent transactions in interstate or foreign commerce in any such products, or if the direct effect of such requirement is to prevent, deter, hinder, or restrict other persons from selling or offering for sale any such products to such retailer in interstate or foreign commerce. . . ."

CAL. CONST. ART. XX, § 22:

> "The State of California . . . subject to the laws of the United States regulating commerce between foreign nations and among the states shall have the exclusive

right and power to regulate the importation into and exportation from the State, of alcoholic beverages."

I

STATEMENT OF CASE

While this case can be decided purely as a matter of law, it is important to understand the factual context in which it arises, particularly in view of the large amount of misinformation in the briefs of Petitioners and their amici.

The great bulk of distilled spirits consumed in California (except brandies) is produced outside the state and must be imported. Nationally advertised brands account for over 90% of California consumption. The brand owners of these brands are large national distilling companies. The six largest distillers in the United States—Seagram, Heublein, Hiram Walker, National Distillers, Schenley and Brown Forman—control the production and distribution of approximately 60% of all distilled spirits consumed in the United States. The next nine largest distillers—Bacardi, Fleischman, Somerset, Gordon Renfield, Jim Beam, Glenmore, Liggett, Buckingham, Foremost-McKesson—control another 25% of the market. JA 16, 28. Because the leading brands are 90% of the market and because nearly all of them are imported into California, a California wholesaler will be excluded from substantially the entire wholesale liquor market in California unless he may import the leading national brands.

The designation procedure at issue here was originally part of California's fair trade apparatus. In the original version of Cal. Bus. & Prof. Code § 23672, the party posting fair trade prices for a brand was given the power to dictate who could import the brand. In 1978, the California Supreme Court invalidated California's liquor fair trade laws as inconsistent with and preempted by the Sherman Act. *Rice v. ABC Appeals Board*, 21 Cal. 3d 431, 146 Cal.

Rptr. 535, 579 P.2d 476 (hereinafter *"Rice"*). Although review of *Rice* was never sought in this Court, the reasoning in *Rice* was substantially endorsed by this Court in *California Retail Liquor Dealers Ass'n v. Midcal, Aluminium, Inc.*, 445 U.S. 97 (1980) (hereinafter *"Midcal"*), which invalidated California's wine fair trade laws. *Rice* did not scrutinize § 23672, but Petitioner Rice, Director of California Department of ABC, decided that *Rice* rendered the original fair trade version of the designation statute unenforceable because the power to designate was delegated to the party posting the fair trade prices, a party which, after *Rice*, could not exist legally. JA 13.

Giving brand owners the power to designate who may import their brand into California may well have served the invalid purpose of the fair trade laws. Because the purpose of those laws was to insure that the brand owner could effectively fix, control and enforce prices at the retail level, it made little sense to allow importers not of his choosing to import his brand into the state. If the brand owner, on the other hand, were given the power to designate who could import, he could easily discipline importers or wholesalers who did not help him to enforce the fixed retail prices by revoking designation. Thus, the original delegation of power to brand owners to designate importers was part and parcel of the statutory scheme of fixed retail prices.

The wholesaler Respondents are fully licensed by the state to import distilled spirits, but prior to *Rice*, these wholesalers had never been able to import major national brands because they were never designated as importers by any of the big distilling companies. In 1978, after *Rice* was decided, the wholesaler Respondents began to purchase major national brands from wholesalers in Oklahoma, whose law permits wholesalers to resell to "qualified

persons" outside the state,[1] Some distillers choose to sell their brands to Oklahoma wholesalers without restriction on resale (but, nonetheless, refuse to designate Respondents as California importers). Oklahoma, in other words, provides a continuing source of major national brands outside the franchise system.[2]

Respondents and the Oklahoma wholesalers observe all reporting, regulatory and tax requirements of the states of Oklahoma and California and of the United States as to the interstate movement of this liquor. These rules and regulations are in fact exactly the same which apply to sales of liquor by the distillers to their franchisees. The Respondents also obtain full legal title to the goods they purchase in Oklahoma, without contractual restriction as to whom and where they resell the goods. In other words, the brand owner has no property or contractual rights in the liquor which Respondents obtain.

Unlike the Respondent wholesalers, the wholesaler-importers designated by the distillers are supplied directly by the distillers. Twelve or so major franchised distributors in California account for approximately 70% of the wholesale volume in the state. JA 18. Petitioner Bohemian (with its sister corporations) is the largest and handles an annual volume larger than the entire consumption of Oklahoma. JA 32. (See also Record, Exhibit B to Amended Petition for Writ of Mandate.)

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[1]On February 9, 1982, the Oklahoma Supreme Court, in *Central Liquor Co. v. Okla. A.B.C. Board,* No. 57-284, reaffirmed that Oklahoma wholesalers may sell to qualified out-of-state wholesalers. While the opinion notes that distillers are not required to sell to Oklahoma jobbers when the goods are destined for other states, the opinion nonetheless recognized that the distiller may choose, as a private contractual matter, to sell to Oklahoma jobbers without any restrictions on resale.

[2]Other such sources have become available elsewhere since 1978, including suppliers who have purchased liquor from distillers without restriction and franchised wholesalers who resell without restriction.

As indicated in the opinion of the California Court of Appeal, the Respondent wholesalers sell to retailers in California at prices below those charged by the designated franchisees. *Norman Williams Co. v. Rice,* 108 Cal.App.3d 348, 353, 66 Cal.Rptr. 563, 567 (1980). Major brand owners (distillers) promulgate to their franchisees lists of "suggested" prices for resale to the retailer. The franchised distributors rigorously adhere to the suggested wholesaler-to-retailer prices to within a few cents a case. JA 19. Thus there is no intrabrand price competition among the various franchisees.

The California court had before it the fact that the importation of brand name liquor from Oklahoma for the first time introduced significant price competition at the wholesale level in California. This fact went unchallenged. The Respondent wholesalers acquire their liquor in Oklahoma at a price several dollars per case *above* that paid by the designated franchisees (because of the Oklahoma jobbers' mark-up and the additional freight). Despite their higher cost per case, the Respondents sold cases to the retailers at net prices which were two to ten dollars below the suggested prices. JA 19. The Respondents were simply willing to take a lower mark-up than the designated franchisees. The resulting effect at the retail level was dramatic: a retailer carrying Oklahoma liquor, for example, would sell a fifth of Cutty Sark for $8 versus a usual retail price of $10.50. O'Donnell & Bamford, *Jack Daniels Meet Adam Smith,* FORBES, Nov. 23, 1981, 163, 164. A.B. 499 would empower the distillers to eliminate the discounting wholesalers, and thus reintroduces fair trade through the back door.

On the issue of price, the brief of the California Attorney General misreads the state court's conclusion, which was that the wholesaler-to-retailer prices charged by the Respondents for Oklahoma liquor are lower than the "suggested" wholesaler-to-retailer prices charged by the

franchised wholesalers. In a mistaken analysis, the Attorney General attacks the state court finding on price by arguing that the California price affirmation statute, § 23673, governs price competition at this level. The latter statute, which deals with *distiller-to-wholesaler* prices, requires the distiller to charge California wholesalers a price no higher than the lowest price charged by the distiller to wholesalers in other states. The price affirmation statute thus has no bearing or effect on price competition at the wholesaler-to-retailer level which would be threatened by A.B. 499.

The Respondent wholesalers handle a large variety of brands and bottle sizes—30 or 40 brands each. The bulk of their sales are to small retailers like the Respondent retailers and not to large discount retailers. (Record, Exh. C to Petitioners' Reply Memo. of Dec. 21, '79 and Exh. C to Petitioners' Replication of Feb. 5, 1980.)

The designation statute was amended by Assembly Bill (A.B.) 499 in 1979 to allow the "brand owner" to designate importers. The Respondent wholesalers each sought designation from all of the major distillers mentioned above, and were without exception denied designation. At this point, they filed the present action in the California courts which resulted in the invalidation of the statute.

II

SUMMARY OF ARGUMENT

A distiller sells to certain wholesalers in California, who compete with a second set of California wholesalers with an entirely independent supplier. This supplier is independent because the distiller has sold branded goods to him without restriction on resale. In selling the goods to this supplier the distiller has also parted with all title to and interest in the goods.

The restriction involved here arises as follows. If the distiller agrees to allow his wholesalers but not the second

group of wholesalers to import his brand into California, then the second group will be prohibited from importing the goods, even though they have legally purchased such goods from their third party supplier free of restriction. It is difficult to imagine any *per se* antitrust violation involving a more naked and outright prohibition on interstate commerce.

This unusual power to prohibit otherwise legal interstate commerce conducted by third parties is conferred by a California statute. The distiller exercises this power simply by agreeing to "designate" his group of wholesalers and refusing to designate the others. The conflict of this statute with the Sherman Act is the immediate issue here, and on this issue it is well established that a state statute may not authorize private parties to violate the federal antitrust laws. *Schwegmann Bros. v. Calvert Distillers Corp.*, 341 U.S. 384 (1951).

The instant case presents issues almost identical to those presented in *Midcal.* Just as it is a *per se* violation of the Sherman Act for fair trade statutes to empower a brand owner to set minimum retail prices for his brand in California, it is a *per se* violation for A.B. 499 to empower a brand owner of liquor to prohibit a wholesaler from importing branded liquor which has been legally purchased from a third party. In fact, A.B. 499 goes beyond fair trade in its anticompetitive effect. The distiller has more than the mere power to control the prices; he can actually decide who may compete and can prevent third parties from freely disposing of their own property.

The Petitioners attempt to attack the state court's opinion on the basis of a remarkable misreading of *Continental T.V., Inc. v. GTE Sylvania, Inc.*, 433 U.S. 36 (1977) (hereinafter *"Sylvania"*). Citing *Sylvania,* they contend that the state court erred in concluding that A.B. 499 authorizes a *per se* violation of the Sherman Act. While it is correct that

Sylvania abolished the *per se* rule against territorial restrictions imposed by a manufacturer on his own franchisee-distributor, *Sylvania* does not empower a distiller to do what A.B. 499 authorizes: To prohibit interstate commerce by *a third party* in goods purchased neither from the distiller nor his franchisee. Although a distiller may impose reasonable territorial restrictions on his own franchisees and terminate a franchisee who violates such restrictions, nothing in *Sylvania* authorizes a distiller or his franchisee to prevent the interstate movement of goods by a third party who has legally purchased those goods without restriction outside the franchise system.

Petitioners argue and Respondents concede that the Twenty-first Amendment gives the state powers it would not otherwise have to regulate commerce in liquor. In the present case, however, the California courts have determined that the statute serves no legitimate state regulatory goal related to liquor. Therefore the exclusionary device authorized by the statute cannot be justified as a liquor measure.

All of the purported state regulatory goals argued here were presented to the California courts. As the legitimate interpreter of the California's regulatory interest, the state courts had no difficulty in rejecting the numerous attempts by Petitioners to contrive some justification for this special interest legislation. The Petitioners nonetheless urge this Court to foist upon the State of California some state regulatory goal which even its own courts had been unable to discern. *Midcal,* however, noted that this Court customarily accepts the findings of state courts as to a state's regulatory interest in the absence of exceptional circumstances.

Because the California courts have established that the statute serves no legitimate state regulatory interest, the statute must also fail as violative of due process since it gives private parties a veto over the state's own licensing

procedure for importers without standards and without review or appeal. Likewise, the statute lacks a regulatory purpose which could justify its blatant discrimination between two groups: designated and non-designated importers. Since both groups have been fully licensed by the state to import, the only difference between them is whether they are in the good graces of a private party.

III

ARGUMENT

A. The Court Below Correctly Concluded That the Designation Statute Would Enforce Private Conduct Which Is Per Se Violative of the Sherman Act

In an opinion firmly anchored in *Midcal,* the California Court of Appeal ruled that A.B. 499 is preempted by the Sherman Act because the state statute, without furthering any state regulatory interest, would authorize a *per se* violation of the Sherman Act. A state may not allow, authorize or sanction private agreements or practices which are *per se* illegal under the Sherman Act. *Schwegmann Bros. v. Calvert Distillers Corp.,* 341 U.S. 384, 386-89 (1951). *Schwegmann* invalidated a Louisiana fair trade law which allowed but did not compel liquor distributors to impose minimum prices.

1. A.B. 499 Empowers Private Parties to Prohibit Commerce of Their Competitors

It is important to understand the operation and effect of a designation under A.B. 499. The statute contemplates that each distiller or brand owner will agree with one or more California importers or wholesalers to sell his brand to the wholesaler and to authorize the wholesaler to import the brand into California. In the absence of the statute, such agreements between a distiller and a wholesaler would have no effect on importers who could legally obtain the same brand from some source other than the distiller, such as an Oklahoma wholesaler.

By operation of A.B. 499, however, anticompetitive consequences would result. If the distiller entered into designation agreements with a number of wholesaler-importers, the legal consequence would be that only the designated importers may import and all other wholesaler-importers would be prohibited from importing the brand, even if they may lawfully obtain the brand without restriction from someone other than the distiller. The statute does more than merely recognize the distiller's right to sell to whomever he pleases. It transforms his agreement to designate and sell to one or more importers into an *automatic* prohibition on importation by non-designated competitors of goods in which the distiller has no property right or ownership interest. The statute *requires* the distiller to enter into designation agreements. The *necessary* effect of the procedure is to exclude all non-designated importers.[3] The State of California would enforce this exclusion by private parties.

The designation procedure is thus a naked restraint on interstate commerce between two parties, an Oklahoma wholesaler and another California importer, who in a free market would be legally able to import liquor into California. In other words, private parties would be allowed and empowered by the State to exclude others from the market.

Amicus Heublein argues that the exclusionary device in A.B. 499 is essentially a unilateral act by the distiller and that there can be no *per se* violation in the absence of an agreement between two parties prohibiting commerce. The A.B. 499 exclusion, however, is not substantially dif-

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[3]The Attorney General of California completely misreads the state court's opinion on the nature of the *per se* violation. While the Attorney General mistakenly maintains that the state court treated this as a "price case" (A-G Brief, p. 26), it is clear from the state court's opinion that the *per se* violation was the exclusion of importers from the market. 108 Cal. App. 3d 348, 166 Cal. Rptr. 563.

ferent in this respect from the conduct found illegal in *Midcal* and *Rice*. In *Rice*, the distiller simply posted retail prices with the State. Not only were there no agreements between the retailer and the distiller; there was not even any contact between them. The retailer purchased from a wholesaler, and the law required that the retailer adhere to the posted retail prices. No agreement, fictional or otherwise, was required between the distiller and the retailer. Cal. Bus. & Prof. Code § 24755. Similarly, in *Schwegmann*, 341 U.S. at 387-389, a Louisiana statute provided that a wholesaler or another retailer could enjoin a retailer *who had not signed a fair trade contract* from underselling the prices fixed in any fair trade contract entered into by the distiller. The requisite contract or combination for a Sherman Act § 1 violation is also deemed to exist in a tying violation, although tying is essentially a unilateral decision by a seller to require his purchaser to buy one product as a condition to selling the same purchaser another product. If an "agreement" or "combination" restraining trade is implied in the latter cases, certainly a contract, combination or agreement should also be implied in the designation procedure.

While technically it is the distiller's refusal to designate which causes the exclusion rather than the distiller's designation agreements, the above discussion demonstrates that an agreement of the distiller with a designated importer is indeed an essential part of the designation procedure. The true vice of the statute is that it permits in some traders to the exclusion of others. Because a designation agreement is necessary to accomplish this overall effect, the designation agreements should be deemed to supply the element of "a combination" or "contract" specified in Sherman Act § 1.[4]

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[4]Considering statutes authorizing market exclusions from a different perspective, P. Areeda & D. Turner, I ANTITRUST LAW ¶ 209 (1978) at pp. 62-64, hypothesize a state statute prohibiting commerce in a particular item except by one company designated by

2. The Designation Procedure, Amounts to a Per Se Violation, of the Sherman Act

This Court has delineated some general tests and criteria for determining whether to apply the *per se* rule to anticompetitive practices. In *The White Motor Co. v. U.S.*, 372 U.S. 253, 263 (1963), *per se* violations were defined as "naked restraints of trade with no purpose except stifling of competition." In *National Society of Professional Engineers v. U.S.*, 435 U.S. 679, 692 (1978), practices were said to be *per se* illegal if their "nature and necessary effect are so plainly anticompetitive that no elaborate study of the industry is needed to establish their illegality . . . ."

Applying the above guidelines for *per se* rules to designation agreements, it is readily apparent that no elaborate industry analysis is required to demonstrate the anticompetitive character and operation of the designation procedure. The necessary effect of the procedure is the outright exclusion of "non-designated" wholesalers with an independent source of supply who could otherwise legally compete. The theoretical possibility that a distiller may designate all importers licensed by the state should not remove designation agreements from the category of

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the state. The authors conclude that such a statute would be preempted regardless of whether a private party or the state is doing the actual "excluding." Even if the monopolist is a passive beneficiary of the statute and has not violated the antitrust laws, the authors argue, the law itself is nonetheless inconsistent with the Sherman Act scheme of free competition. The authors conclude that a state may not prohibit market entry or price competition which is favored by the Sherman Act. The same logic should apply here. Even if a distiller does not violate the antitrust laws by designation, the designation statute itself prevents free interstate competition.

Alternatively, the element of combination required in Sherman Act § 1 may be deemed to exist in the present case by virtue of the State's cooperation in enforcing the exclusions made by the distillers. *Parker v. Brown*, 317 U.S. 341, 351-352 (1942).

per se violations. As this Court observed in *Catalano, Inc. v. Target Sales, Inc.*, 446 U.S. 643 (1980):

> "In any event, when a particular concerted activity entails an obvious risk of anticompetitive impact with no apparent potentially redeeming value, the fact that a practice may turn out to be harmless in a particular set of circumstances will not prevent its being declared unlawful *per se*." *Id.* at 649.

A.B. 499 certainly contemplates that the distiller will designate less than 100% of the importers licensed by the state.[5] Otherwise, the statute would have been totally superfluous.

Likewise it is irrelevant to the *per se* analysis that the statute does not limit the number of designees. Even if the distiller designates ten authorized importers, the real issue is whether the designation procedure excludes additional wholesaler-importers who would be able to operate in a free market. Such exclusions are definitely contemplated by the statute, which, to repeat, would otherwise have been superfluous.

3. Respondents Need Not Show That the Operation of the Statute Fits Exactly into a Previously Established Per Se Violation

The particular exclusionary practice authorized by A.B. 499 is analogous to many *per se* violations delineated in private antitrust cases. In general, an agreement between two or more parties depriving a third party of a source of supply is a *per se* violation. For example, in *Klor's, Inc. v. Broadway-Hale Stores, Inc.*, 359 U.S. 207

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[5]In *Joseph E. Seagram & Sons v. Hostetter*, 384 U.S. 35, 46 (1966) relied upon by Petitioners, the shoe was on the other foot. There this Court found no preemption because the possibility of conflict between federal and state law was "entirely too speculative." Here the possibility of no conflict is entirely speculative.

(1959), a retailer's agreement with manufacturers of electrical appliances not to sell to the retailer's competitor was found to be *per se* illegal. Another "group boycott" case, *U.S. v. General Motors Corp.*, 384 U.S. 127, 147 (1966), provides a closer parallel to the designation procedure in its anticompetitive effect. There, one group of GM dealers obtained GM's agreement to prohibit the second group of dealers from reselling GM cars to discounters. The Court noted that such a course of conduct was a "classic" restraint of trade, since it deprived the second group of dealers of their freedom to deal with the discounters if they so chose. *Id.* at 140.

The designation statute is likewise analogous to certain established *per se* violations where competition is excluded through an exclusionary membership policy in a trade association. For example, in *Associated Press v. U.S.*, 326 U.S. 1 (1945), *each* of the 1,300 newspaper members of the Associated Press had the right under the Association's By-Laws to veto the admission of its business competitor. Since the by-laws also prohibited sale of the Association's wire service to non-members, it was very difficult for a non-member to buy news. These exclusionary By-Laws were found to be a *per se* violation. As in the *Associated Press* case, a wholesaler in the present case must become part of "the club"—i.e., he must be "designated"—before he can effectively compete. *Id.* at 27-29.

The Petitioners misleadingly attempt to shoehorn the designation procedure into the rule in *U.S. v. Colgate & Co.*, 250 U.S. 300 (1919). They contend that A.B. 499 merely confirms the unilateral right of each distiller to refuse to sell his brands to the Respondents. Such unilateral refusals are, of course, not judged under *per se* rules. However, the issue here is not, as the Petitioners erroneously contend, the freedom of the distillers to refuse to sell to Respondents, but whether the distillers should be allowed to pro-

hibit Respondents from purchasing from a third party. Respondents do not contend that federal law requires that the distillers sell directly to them. Respondents have a source of supply independent of the distillers, with which A.B. 499 would allow the distillers to interfere. In other words, A.B. 499 is not designed to allow the distiller to dispose freely of his own property; it allows him to interfere with someone else's free disposition of *his* own property.

The California court did not establish a new *per se* violation; it simply concluded that designation fell under the already well-delineated category of *per se* violations which "deprive others of access to merchandise which the latter wish to sell to the public. . . ." *U.S. v. General Motors Corp.*, 384 U.S. at 146. It is the ultimate in legal formalism to suggest that designation must be on all fours with a *particular* previously defined *per se* violation before it can be found to be inconsistent with the Sherman Act. The Sherman Act should be applied flexibly to anticompetitive devices and artifices. Were lower courts constrained to apply *per se* rules only in situations where the practice under consideration was on all fours with some particular previously defined *per se* violation, antitrust violators could easily evade the law by slight modifications to practices previously declared illegal.

The absence of a private antitrust case on all fours with the designation procedure reflects the fact that the statute delegates to private parties a power to prohibit interstate commerce so naked and so drastic that they could achieve it on their own only with the greatest difficulty. To conceive of a private antitrust case involving a practice analogous to the designation procedure, but effected strictly by private parties, one would have to imagine a device by which A and/or B could prevent C from bringing into the state goods which C had purchased from D. Short of a conspiracy to impede C physically at the state border, it is almost impossible to conceive of how private parties could

prohibit such commerce by strictly private means. The great difficulty in accomplishing such a restriction by private means only underlines the drastic power which has been created by the statute.

4. A.B. 499 Conflicts Inescapably with the Sherman Act

The state statute, then, authorizes, enables and enforces private conduct which excludes another trader from the market. Petitioners argue that, because A.B. 499 does not *require* a violation of the Sherman Act, there is no actual conflict between the two statutes and no preemption. Respondents concede that the state statute does not compel a distiller to exclude: he could theoretically designate all licensed importers. However, as explained above, the statute *authorizes* exclusions from the market, and this is enough to create an irreconcilable conflict while the Sherman Act. *Schwegmann, supra.* "[T]he State . . . may not simply authorize private parties to engage in activity that would violate the Sherman Act." *Community Communications Co. v. City of Boulder,* 50 U.S.L.W. 4144 at 4151 (January 13, 1982, dissenting opinion by Justice Rehnquist). For example a state statute authorizing horizontal agreements between private parties to allocate customers or territories would clearly be preempted by the Sherman Act even if it did not *require* such allocations. Petitioner Wine & Spirits Wholesalers concedes this point (Br., pp. 11-14). *See also* P. Areeda & D. Turner, I ANTITRUST LAW ¶ 209 (1978) at p. 60. The conflict between A.B. 499 and the Sherman Act is thus not merely some abstract or potential inconsistency regarding the competitive policy behind the two statutes. There is an inescapable conflict because the state statute authorizes a *per se* violation of federal antitrust law.

5. Sylvania Condones Restrictions Only on Franchisees, Not on Third Parties Outside the Franchise System

Petitioners maintain that there is no inescapable conflict with the Sherman Act because designation is at most a rule of reason violation rather than a *per se* violation. In other words, the argument is that designation will only violate the antitrust laws in certain circumstances. Petitioners contend that designation is analogous to territorial restrictions on franchisees, dealt with in *Sylvania*. In that case, the Court held that a territorial restriction imposed by a manufacturer on his franchisee should be judged under the rule of reason analysis rather than a *per se* rule. The Court found that such restrictions, while they concededly impaired int*ra*brand competition (between Sylvania's distributors), *may* have redeeming benefits.[6]

A.B. 499 is not analogous to *Sylvania*, because A.B. 499 restrictions act on different parties than do *Sylvania* restrictions. The rule of reason in *Sylvania* may well allow a distiller to prohibit *his own* franchisee from reselling his brand to a third party in another state. In the present case, however, the distiller sells his brand without such restrictions to an Oklahoma wholesaler. Such branded goods are then legally resold without restriction to a third party. Once a manufacturer has sold his branded goods without restriction, *Sylvania* does not allow him to go to the border and prohibit subsequent purchasers from carrying the goods over state lines.

Sylvania, in other words, stands for the principle that a manufacturer may impose reasonable territorial restric-

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[6] *Sylvania* did not find such restrictions to be *per se* legal. Such restrictions may still violate the Sherman Act if they in fact unreasonably restrain trade and provide no demonstrable benefit to int*er*brand competition.

tions on the operations of *his own franchise* as a condition to selling to that party directly. Should the franchisee violate such restrictions, *Sylvania* gives the manufacturer a remedy: terminate the franchise. *Sylvania,* however, does not give the distiller any power to reassert control over goods which have left *or never entered* the franchise system. If third parties may legally obtain the manufacturer's goods in a state where the distiller has sold them without restriction, *Sylvania* creates no remedy against the subsequent interstate movement of such goods.[7]

Certain distillers are currently willing to sell their brands to suppliers outside California without restriction on resale. Presumably these distillers find it profitable to do so. Once the goods have been sold to Oklahoma jobbers, they may freely and legally resell the goods to third parties like Respondents. Having voluntarily let the goods escape from the franchise system, the distillers may not now seek in *Sylvania* a justification for prohibiting commerce in such goods by third parties who have obtained the goods without contractual restriction. Neither could the California courts perceive any California state regulatory purpose for nullifying this side effect of the distillers' decision to market their brands in Oklahoma.

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[7]Under *Sylvania* the manufacturer's sole remedies are to impose restrictions on his own franchisees and refuse to sell to those franchisees if they violate the restrictions. In *Adolph Coors Co. v. A&S Wholesalers,* 561 F.2d 807 (10th Cir. 1977), a preliminary injunction obtained by a brewer against a non-franchisee transporting the brewer's brand in interstate commerce was found to be wrongful and was dissolved. 561 F.2d at 809, 811.

Petitioners argue that the net effect of A.B. 499 is the same "as if" vertical restrictions had been originally imposed by the distillers on the Oklahoma jobbers. This "as if" argument asks this Court to legitimize a restriction on the basis of an assumption contrary to fact. The fact is that some distillers sell to jobbers without such restrictions. The true issue therefore is not whether a vertical restriction has been imposed in Oklahoma but whether, having sold goods *without* vertical restrictions in Oklahoma, the distillers may employ a different and much more drastic restriction to subsequently exclude such goods from interstate commerce. This alternate drastic restriction must be judged on its own merits. If the Court is to condone such a restriction, it would be opening the door to the dangerous and incorrect principle that a manufacturer may reassert control over goods which he has sold or which have been resold without restriction and which have become the property of another party. Under the principles urged by Petitioners, nothing would seem to prevent a manufacturer from reasserting control over such goods even after they had reached the hands of the consumer.

A.B. 499 is not a restriction imposed by a manufacturer on his own distributor—a vertical restriction. When A selling to B is in competition with C selling to D, the statute authorizes A to reach directly across (not up and down) the ladders of distribution and block trade between C and D. The issue presented by the case is really whether one chain of distribution should be able to block a competing and independent chain of distribution. Not only in "direction" but also in its outright prohibitive effect, such a restriction is more analogous to horizontal restrictions than to *Sylvania*. The present case, therefore, does not resemble *Sylvania* in such "geometrical" terms, and it is equally obvious from the section below that the policy

considerations behind Sylvania are totally inapplicable here as well.[8]

6. There Are No Redeeming or Pro-competitive Benefits from A.B. 499

While the exclusionary effects of designation agreements are obvious, it is equally obvious that there are no counterbalancing competitive benefits from the statute which would warrant removing it from the *per se* illegal category. Erroneously invoking the policy considerations discussed in *Sylvania,* Bohemian claims that the restrictions which A.B. 499 imposes on int*ra*brand competition will promote int*er*brand competition and that, because of this redeeming virtue, A.B. 499 should not be judged under a *per se* rule. The argument is essentially that the exclusion of discounting importers and the consequent maintenance of high prices will encourage the franchisees to undertake promotional and advertising activities which will strengthen the brand. It is further argued that the high mark-ups protected by A.B. 499 would assist franchisees in the introduction and promotion of new brands or old sluggish brands.

Because virtually all brand advertising and promotional activities for the major brands are performed by the distillers themselves at a national level, the factual basis of this argument is questionable. The distillers' lack of any true interest in encouraging brand promotion by the franchisees is reflected in the fact that most of the large franchisees carry competing brands of different distillers. For example, Petitioner Bohemian, which touts its role as a promoter of brands in interbrand competition, in fact

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[8]Petitioners cite *Grant-Billingsley Wholesale Liquor Co. Inc. v. Lennen,* appeal dismissed 449 U.S. 943 (1980) in support of their *Sylvania* argument. This case is distinguished factually and legally in the discussion in Respondent's Brief in Opposition to Petitions for Cert., pp. 22-25.

carries over nine brands of scotches owned by five different and competing brand owners or distillers.[9]

Even assuming that the factual basis of this argument is correct, the real issue here is *whether the State of California, not the distiller, has a legitimate interest in intervening in a free market to encourage more advertising.* Although the state has a regulatory interest in temperance, it is certainly indifferent as a regulator to promoting new brands or old sluggish brands, especially if this is done at the expense of the exclusion of some traders from the market.

There is no other product for which the State of California prohibits free competition for the sake of encouraging promotional activities. If the state is to intervene in a free market for the sake of elevating prices to help finance more advertising and promotion, liquor should be the last product for which the state would want to do this. If anything, the state has an interest in encouraging less advertising of liquor. The purpose of the California ABC Act is the promotion of temperance. Cal. Bus. & Prof. Code § 23001. That advertising is a threat to temperance is clear from the many regulatory controls on it, e.g., no advertising on television.

The other possible kinds of enhancement of interbrand competition involved in *Sylvania* are likewise absent here. *Sylvania* dealt with the television industry, where it is important to product quality to encourage franchisees to invest in facilities for warranty service. *Id.* at 55. The reputation of a brand of television often depends on the easy availability of such services. While it may be important to protect a television dealer from intrabrand

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[9]Including Johnny Walker Black & Red (Somerset), Chivas Regal (Seagram), One Hundred Pipers (Summit), Whitehorse and Passport (Calvert). PATTERSON'S CAL. BEV. J., Dec. '81, pp. 123A-127A. Numerous other examples of such brand "piggybacking" are listed in the latter periodical.

competition from discounters who sell the television but do not provide the warranty services, warranty services are totally unnecessary in the liquor industry.

While the state has no regulatory interest in expanding the advertising aspect of interbrand competition, it is equally obvious that the statute will inhibit in*ter*brand price competition. The *factual* contention that suppression of in*tra*brand price competition in the California liquor industry would in any way enhance in*ter*brand competition was specifically considered and rejected by the California Supreme Court in *Rice*. Based on detailed price statistics, that Court concluded that suppression of intrabrand price competition under fair trade actually *impaired* interbrand price competition in the California liquor market, and in fact tended to encourage uniform interbrand pricing. 21 Cal.3d at 454-56, 579 P.2d at 491-92.[10] On the other hand in*tra*brand price competition will promote interbrand price competition, because the undercutting of the suggested prices by Respondents on one brand will cause the franchisees of a *competing* brand to consider meeting Respondents' price.

While arguing on the one hand that the consumer should be "taxed" with higher markups to pay for franchisee promotional devices, Bohemian also argues that distillers nonetheless have an interest in keeping the wholesaler-to-retailer prices as low as possible and will thus avoid excessively costly promotional services. Apparently assuming that lower wholesale prices will increase sales, Bohemian maintains that the interests of distillers with respect to price are congruent with those of consumers. History dis-

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[10] *Sylvania* does not hold that suppression of intrabrand competition will automatically enhance interbrand competition. To the contrary, the *Sylvania* court held that the degree of intrabrand competition and interbrand competition is totally independent. *Id.* at 51 n.19.

proves this contention. *Rice* noted that, when the distillers had the power to dictate California retail prices under fair trade, they set prices at a level which made them the highest in the nation. *Id.* 455. When *Rice* removed fair trade, and retail prices could become more responsive to supply and demand, California's retail liquor prices plummeted.

The history of fair trade thus demonstrates that the distillers would like retail prices to be higher than free competition would otherwise dictate. The reason for this is not hard to see. As noted in *Rice,* high liquor prices do not depress consumption. *Id.* at 457. Nor do low prices increase volume: consumption in California did not significantly increase when the end of fair trade brought markedly lower prices. With volume not dependent on price, the distillers have an interest in keeping wholesaler-to-retailer prices as high as possible. This removes the competitive pressure which wholesalers would otherwise exert on the distillers to lower the distiller-to-wholesaler prices. With prices one dollar higher per bottle, the wholesaler can get the same markup, but the distiller can get an extra dollar of revenue per bottle with no loss in volume.

In the absence of a *state* regulatory interest in more advertising, the consumer should certainly be given the free market choice between a discounter and a more expensive retailer whose prices reflect the cost of financing sales gimmicks, promotional frills and advertising.

Petitioners suggest that this case be used as a vehicle for extending *Sylvania* to hold that vertical territorial restrictions are *per se* legal. The discussion above amply demonstrates that this case involves neither a vertical restriction nor any of the underlying policy issues in *Sylvania.* Because there is no *Sylvania* type restriction involved here, this is not an appropriate case to extend *Sylvania.*

B. The Statute Is Not Saved from Preemption by the Twenty-first Amendment or the State Action Exemption

1. An Interest-Weighing Analysis Should Be Used

In deciding that A.B. 499 was not saved from preemption by the Twenty-first Amendment, the California Court of Appeal again reached a result compelled by *Midcal*. While the states obviously possess a large measure of control over the regulation of liquor, *Midcal* holds that, where state liquor laws and federal antitrust law conflict, state and federal powers over liquor must be harmonized in an interest-weighing analysis where "the national policy in favor of competition" is balanced against the state's own regulatory interests. *Midcal, Id.* at 101. Here the balance should be easy to strike. While the above discussion has shown that A.B. 499 inescapably conflicts with the Sherman Act, the courts of the State of California itself concluded that A.B. 499 would serve *no* legitimate state regulatory goals.[11]

2. The Statute Serves No Legitimate State Regulatory Goal

As this Court noted in *Midcal*, great weight should be given to a state court's evaluation of the relative interest of the state. Despite the numerous after-the-fact attempts of the Petitioners to contrive some regulatory purpose for this statute, the California courts could find no legitimate California state regulatory interest. Each of the purported goals presented here was rejected by the state court as insignificant. *Norman Williams, supra,* 108 Cal. App. 3d 348, 361, 166 Cal. Rptr. 563, 572. Respondents, however,

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[11]Whether the statute serves any legitimate state regulatory goal or interest is an issue also relevant to the other constitutional grounds on which Respondents have attacked it. Intrusion on due process or equal protection may only be justified by a rational regulatory purpose.

urge this Court to second guess California's own courts as to what California's regulatory interest is.

Petitioners' numerous attempts to contrive some regulatory purpose for the statute contrast with the absence in the statute itself of any standards or criteria for its own administration. In fact, as noted by the state court, the statute's delegation of power to private parties is "broad" and "unqualified" and the statute provides for no review by or appeal to a state agency to insure that state interests are in fact furthered. *Id.* at 361, 166 Cal. Rptr. 563, 572. Because the statute allows the brand owners to designate or refuse to designate arbitrarily, the statute can hardly serve any coherent regulatory policy in a rational manner.

The committee and caucus reports of the statute in the California legislature are likewise devoid of reference to any legitimate regulatory goal. JA 55-75. It is also apparent from these reports that Petitioner Rice, the Director of California ABC, neither sponsored nor supported this statute in the California Legislature. It would also appear that the commitment of Rice, versus the California Attorney General, to this type of regulation is dubious. In a recent interview, O'Donnell and Bamford, *Jack Daniels, Meet Adam Smith*, FORBES, Nov. 23, 1981, pp. 163-169, Rice, described as "the best known of the new brand of liquor deregulators", welcomed the arrival of price competition in the liquor business:

> "What's shaping up in the liquor business today is a classic case of survival of the fittest—similar to developments in the airline, trucking and savings and loan industries. 'Those that can adapt, will. Those that can't, perish,' says Rice, sitting in shirtsleeves in his overheated Sacramento office. 'That's the way the free enterprise system is supposed to work.' " *Id.* at 163.

Petitioners' various attempts to contrive some justification for the statute, which were each rejected by the state court, include:

a. *Promotion of temperance and protection of small retailers.* The only way in which the statute could conceivably serve these two goals would be by increasing prices. While it is clear that the statute will increase prices by excluding competition, the California Supreme Court in *Rice,* 21 Cal. 3d at 457, as endorsed by this Court in *Midcal,* determined that higher liquor prices promote neither temperance nor the preservation of "mom and pop" retailers. Under fair trade, California had the highest retail prices in the nation, and at the same time nearly the highest liquor consumption per capita. Market analyses cited in *Rice* also disproved the notion that small retailers can survive only when prices are artificially high. *Id.* at 455-457. Respondents, in fact, sell most of their goods to small retailers.

b. *Facilitation of the Tracing of Imported Liquor and of Auditing for Tax Purposes.* The legislative history of the statute is devoid of any reference to such an *actual* statutory purpose, and it is readily apparent that the statute does not serve these functions. The state court concluded that without A.B. 499 the California liquor industry is already subject to a comprehensive if not duplicative monitoring and auditing system which ensures that all legitimate federal and state informational interests are fully realized.[12] This system of reports and records, without A.B. 499, provides numerous cross-checks and independent verifications at all levels of the distribution chain by which importation, taxation, quantities, brands and prices can be easily monitored in exhaustive detail. All shipments, sales and transfers of liquor must be reported by all parties involved. These reporting requirements apply equally to liquor acquired from the primary

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[12]The complex web of state and federal controls includes California Department of Alcoholic Beverage Control (ABC) regulations, 4 Cal. Admin. Code, §§ 1, *et seq.*, California State Board of Equalization regulations, 18 Cal. Admin. Code §§ 2500, *et seq.*, and U.S. Bureau of Alcohol, Tobacco, and Firearms regulations, 27 C.F.R. §§ 194.221, *et seq.*

source (the distillers) or a secondary source (such as an Oklahoma jobber). To export to California, the Oklahoma jobbers are required to submit their out-of-state records to the jurisdiction of the California regulatory system. Cal. Bus. & Prof. Code § 23366.3.

A.B. 499 provides for no additional information or records. The language of the statute itself thus utterly fails to support Petitioners' contention that the goal was one of information or auditing. If Petitioners' argument is that eliminating some competitors will reduce the administrative burden of auditing imports or taxation, the elimination should be made by the state itself and not by self-interested members of the industry.

c. *To Offset Effect of Oklahoma Law.* The Petitioners also argue that the regulatory purpose of A.B. 499 is to allow California to foreclose intrusion on its regulatory system from Oklahoma's "open wholesaling" system. Because Oklahoma liquor comes fully under the control of California's comprehensive import and tax auditing system, the California court found that California has no inherent regulatory interest in forestalling the side effects of the Oklahoma system. Oklahoma liquor no more "interferes" with California's regulatory system than does liquor imported by the designated importers, as to which the same reports, controls, verifications, inspections, and audits are available. It is obvious that the only threat from Oklahoma is not to California's regulatory system but to the high prices maintained by the distillers and their franchisees.

d. *Encouragement of Advertising and Promotional Activities by Franchisees.* See discussion above, pp. 20 to 23.

e. *Preservation of the Three-Tier System.* California statutes already in place require a "three-tier" system, i.e., separate and independent ownership of the manufacturing, wholesaling and retailing tiers. Cal. Bus. & Prof.

Code §§ 23772, 25500 *et seq.* The policy behind this requirement is obviously to prevent large concentrations of economic power in the marketing of liquor by forbidding vertical integration. The three-tier requirement thus reflects an antitrust policy. The franchise system, by giving the distillers enormous control over the wholesaling tier, is actually somewhat at odds with the goals of the three-tier requirement. Rejecting Petitioners' attempt to justify A.B. 499 as an attempt to preserve the three-tier system, the court below found that, by giving the distillers even more control over the wholesale tier, the statute is actually counterproductive to the State's goal of insuring the independence of retailers, wholesalers and manufacturers. 108 Cal.App.3d 348, 369, n.3, 166 Cal.Rptr. 563, 572. On the other hand, importation of name-brand liquor which has come through the hands of an Oklahoma jobber would in fact further the purpose of the three-tier system by insulating California wholesalers and retailers from the economic power of the distillers. Even if one conceives of the Oklahoma jobbers as a "fourth tier," such an additional tier would help to preserve the independence of the tiers.

f. *Product Quality Control.* The designation statute has absolutely nothing to do with public health or safety, quality control or proper labelling. Federal regulations already in place preclude labelling or adulteration problems at the distribution level. Brand-name liquor is typically bottled, sealed and labelled outside the state and then packed into cases and loaded into trucks or boxcars for shipment to California. During distribution, the bottle, the label and the seal may not be altered or tampered with. U.S. BATF Reg., 27 C.F.R. §§ 5.31, 194.251, 201.531, 201.550a, etc. Whether a distributor has been designated to import by a brand owner is irrelevant to product authenticity or quality, since all bottles bearing the brand label are identical in all respects.

g. *Ensuring Moral and Financial Integrity of Distributors.* To import liquor into California, one must

obtain a state license. The licensing statute and process requires a "thorough" investigation into the licensees' background as to matters "which may affect the public welfare and morals," as well as into matters of public convenience and necessity. Cal. Bus. & Prof. Code § 23958. This licensing system is of course administered by the state itself. All of the wholesaler Respondents already have the necessary state license(s) and have thus met the moral and financial qualifications prescribed by the state. The designation statute provides no such standards for the selection of importers and can add nothing to this licensing procedure other than the self-interest of the brand owners.

While A.B. 499 will inhibit price competition and help to entrench the position of the leaders of an already highly concentrated market, it serves no legitimate state regulatory goal, be it actual or constructive.

3. The Midcal Dictum

The balance struck by the state court between federal and state interests is reinforced by California Constitution Article XX, § 22, which expressly acknowledges that the state's power to regulate importation of liquor into California is "subject to the laws of the United States" enacted under the Commerce Clause. Any interest weighing analysis under *Midcal* must begin with the California Constitution's own acknowledgment of the preeminent federal power in this area. If a California statute regulating the importation of liquor is inconsistent with the Sherman Act, the federal statute must prevail even as a matter of California law. Even if California may control liquor importation under the Twenty-first Amendment, it has specifically waived this right in its own constitution in cases where such regulation is inconsistent with Federal law enacted under the Commerce Clause.

Despite its inconsistency with the Sherman Act and with the provisions of Article XX, § 22, Petitioners none-

theless maintain that A.B. 499 is saved from preemption by the Twenty-first Amendment. In making this contention they have seized upon the following dictum from the *Midcal* opinion:

> "The Twenty-first Amendment grants the States virtually complete control over whether to permit importation or sale of liquor and how to structure the liquor distribution system." *Id.* at 110, 63 L. Ed. 2d at 246.

Petitioners claim that the present case is distinguishable from *Midcal* because A.B. 499 purportedly concerns whether to permit importation and how to structure the distribution system, while the wine fair trade statutes invalidated in *Midcal* concerned some other aspect of regulation. In essence, Petitioners argue that the *Midcal* balancing test is not to be applied to statutes which in any way concern importation or distribution.

In interpreting this dictum, the California court believed that the reference to a state's "virtually complete control over *whether to permit importation or sale*" referred to the power of the state to prohibit the importation or sale of liquor *entirely*. 108 Cal.App.3d 348, 359, 166 Cal.Rptr. 563, 570. One of the primary purposes of the Twenty-first Amendment was to allow a state to remain dry if it so chose. 76 CONG. REC. 4141 (remarks of Sen. Blaine, sponsor of the amendment in the Senate).

Once a state has decided to allow the importation and sale of liquor by private parties, the Twenty-first Amendment cannot justify a privately administered system of exclusion which furthers no legitimate state regulatory purpose. The Twenty-first Amendment is directed at guaranteeing the *state* a place in regulating interstate commerce in liquor.[18] The present case involves not the state

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[18]Petitioners mistakenly rely on *Heublein, Inc. v. S. Carolina Tax Cmsn.*, 409 U.S. 275 (1972) to suggest that the Twenty-first

itself as a regulator but a private system of regulation, which is unsupervised by the state. See below, pp. 32 and 33.

Neither can A.B. 499 be defended as an attempt to "structure the liquor distribution system." This language in *Midcal* obviously reconfirms that a state has the power to adopt such "structures" as a state monopoly, *see, Midcal,* 445 U.S. at 1061, n.9, or a three-tier system. The principal claim that A.B. 499 is "structural" in nature is that it is designed to preserve the three-tier system. While the three-tier requirement, which exists in California law independently of A.B. 499, is obviously directed at "structure," A.B. 499 has nothing to do with the three-tier requirement, as explained above.

Petitioners maintain that a private device for excluding some wholesalers is itself a "structure" and thus immune from antitrust law. If the term "structure" is interpreted this broadly, then nearly every aspect of liquor distribution would be immune from the antitrust laws. For example, if "structure" can refer to the exclusion of some wholesalers by designation, it could just as easily include a state law authorizing exclusion of wholesalers by a group boycott agreement between distillers. "Structure" as used in *Midcal* must certainly refer not to private exclusionary devices against wholesalers, but to more overriding structural issues like whether wholesaling is to be in private hands at all or whether the state should prohibit all wholesalers from importing.

Amendment validates far greater restrictions on importation than are at issue here. The South Carolina statute there provided that only a manufacturer could import, but the case involved a tax issue rather than an antitrust challenge to the statute. In any event, it is one thing for the state itself to prohibit *all* wholesalers from importing, as in S. Carolina, and quite another for A.B. 499 to delegate to private parties the unsupervised power to exclude some wholesalers.

If the *Midcal* dictum indeed means that the *Midcal* preemption analysis does not apply to statutes pertaining to "structure" and "importation," as Petitioners interpret these terms, the dictum would swallow the holding in *Midcal*. Certainly, the fair trade statute in *Midcal*, which made it illegal to sell except at a specified price, was a measure affecting the structure of distribution in the broad sense in which Petitioners use the term. In fact, the *Midcal* opinion itself recognized that one of the principal *purported* purposes of the fair trade statutes (which they did not achieve) was to preserve a system of small retailers. *Midcal*, 445 U.S. at 113. Likewise, the wine price maintenance statutes invalidated in *Midcal* also regulated the terms of importation,[14] because these statutes empowered out-of-state suppliers of wine to control retail prices in California for their brands when imported into the state. Because *Midcal* itself dealt with a statute directed at certain aspects of distribution and importation, it is readily apparent that Petitioners' reading of the *Midcal* dictum is far too expansive.

4. The State Action Exemption

Having dealt with the Twenty-first Amendment, the court below proceeded to the issue of whether A.B. 499 was saved from preemption by the "state action exemption" to the antitrust laws. *Midcal* held that this exemption would not be triggered unless there was some active supervision by the state with respect to the regulatory scheme. The A.B. 499 regulatory scheme, as held by the court below, cannot be construed to be such state action. The state has simply delegated regulation to private parties without providing any standards for the regulation of

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[14]Cal. Bus. & Prof. Code § 24867, required out-of-state brand owners of wine to "designate in writing one licensee who imports the brand of wine to make and file a fair trade contract . . . ." Although this section was not explicitly at issue in *Midcal*, it was in effect invalidated by *Midcal*.

competition and without overseeing or reviewing in any way the choices made by the private parties.[15]

Morgan v. Div. of Liquor Control, 1981-2 Trade Cases, ¶ 64,366 (2d Cir. 1981) and *New Motor Vehicle Bd. of Cal. v. Orin W. Fox Co.*, 439 U.S. 96 (1978) are distinguishable with respect to the applicability of the state action exemption. *Morgan* involved a statute where the state itself set certain uniform fixed percentage markups for liquor wholesalers and retailers. Such direct state action and control left no discretion to these private parties with respect to markup. In *New Motor Vehicle Bd.* the only power or prerogative granted to private parties was the right of an existing automobile franchisee to file a protest against new proposed franchise with a state board, which would review and rule on the protest in accordance with certain criteria stated in the statute. No such state involvement occurs with designation.

C. A.B. 499 Is Also Preempted by the Federal Alcohol Administration Act

Several additional independent federal grounds support the decision below. The result below may be affirmed on these grounds, even though they were not relied upon nor ruled upon by the court in its opinion below.

A.B. 499 is not only inconsistent with the Sherman Act but also inconsistent with and preempted by the unfair competition provisions of the Federal Alcohol Administra-

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[15]Petitioners argue that there is a possibility that such active supervision would be provided by the state in the future in the form of amplifying regulations. However, the Director of the California Department of ABC has already issued regulations pertaining to A.B. 499 (Appendix F to Wine & Spirits Wholesalers' Petition), and these regulations contained no provision for supervision or review by the state of the private designation agreements. Because there is no indication that the Director will issue further regulations and no requirement that he do so, this Court should not consider this purely hypothetical possibility of state supervision.

tion Act, § 5, 27 U.S.C. § 205, which prohibits any indirect requirement by a distiller that a retailer purchase from one wholesaler to the exclusion of another "if such person [distiller] engages in such practice to such an extent to . . . prevent transactions in interstate . . . commerce. . . ." A.B. 499 is inconsistent with this statute because it indirectly gives the distiller the power to prevent interstate transactions so as to require that retailers purchase its brand of distilled spirits only from designated wholesalers to the exclusion of like distilled spirits offered by non-designated wholesalers. Such an exclusion is illegal under § 205 if it is accomplished "by agreement or otherwise" and whether it is done "directly or indirectly."

This Court has made it clear that § 205 is remedial in nature and that accordingly its language should be given a "hospitable scope." *Black v. Magnolia Liquor Co.*, 355 U.S. 24, 26 (1957). The purpose of § 205 is to prevent practices analogous to antitrust violations, *Id.* at 25. While the federal statute is obviously intended to promote and protect free competition by prohibiting marketing arrangements which exclude competing importer wholesalers, A.B. 499 authorizes such exclusive arrangements. Because the state statute enables the distillers to require indirectly that the retailers purchase only from the designated importers by preventing interstate competition, and the federal statute prohibits any such requirement, there is an inescapable conflict between the two statutes. At the very least, § 205 indicates that, despite the Twenty-first Amendment, there is an express, preeminent[16] and direct federal interest in prohibiting exclusionary or anticompetitive practices in the interstate marketing of liquor.

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[16]Again, the state statute is not saved from preemption by the Twenty-first Amendment, particularly because this Court has already held that § 205 is a constitutional exercise by Congress of its powers under the commerce clause. *William Jameson & Co. v. Morgenthau*, 307 U.S. 171, 172 (1939).

D. Deprivation of Due Process

Predictably, a private system of regulation like A.B. 499 tramples upon numerous constitutional guarantees. Because the present case was decided so soon after the *Midcal* decision and because it bears such a close resemblance to *Midcal*, the state court had strong reasons for anchoring its opinion solely in *Midcal*. However, the state court's opinion notes at several points the basic unfairness of allowing one group of businessmen to exclude their competitors. *See, e.g.*, 108 Cal. App. 3d 348, 356-358, 361, 166 Cal. Rptr. at 569, 570, 572. In this respect A.B. 499 denies both due process and equal protection of the law. As this Court recently noted in *Midcal*, the states cannot "insulate the liquor industry from the Fourteenth Amendment's requirements of equal protection [citation] and due process . . .", *Id.* at 108 (citations omitted).

With respect to deprivation of due process, A.B. 499 delegates the power to regulate importation to distilling corporations who have their own selfish interests with respect to the licensing of importers. These private parties are granted a power which they would not have absent the statute, namely the power to prevent an importer properly licensed by the state from importing goods which that importer has legally obtained in another state. This power may be exercised simply by refusing to designate an importer as "authorized." The statute, moreover, provides for no supervision or control by the state over the distillers' exercise of this delegated power and provides no standards or criteria to circumscribe or guide the distillers in the exercise of the power. The state has thus given to private parties a virtual veto over its licensing process. It has also given one private party the power to prevent another private party from freely disposing of his own property.

If the power to license importers is to be delegated to the distillers, due process requires that it be delegated in

such a way as to protect prospective importers from arbitrary or capricious refusals to license. Since A.B. 499 superimposes a second tier of private licensing over the state's licensing process, the designation procedure should be subject to the same due process requirements otherwise applicable to the granting or revocation of liquor licenses. *Hornsby v. Allen*, 326 F.2d 605, 609 (5th Cir. 1964), confirmed that due process applies to the granting or denying of liquor licenses. The statute violates due process in the following respects:

1. In *Gibson v. Berryhill*, 411 U.S. 564 (1973), this Court found a denial of due process in a statute which, like A.B. 499, delegates the power to license to private persons with a "substantial pecuniary interest" in the licensing process. *Id.* at 578-79.

2. A.B. 499 provides absolutely no regulatory criteria or standards to limit the private delegate in his exercise of the power to designate. A distiller is free under the statute to refuse to designate on arbitrary or capricious grounds.

3. The statute fails to require a hearing or opportunity for review or appeal for an aggrieved importer who has been refused designation.

E. Denial of Equal Protection

A.B. 499 is also invalid because it discriminates between two groups of licensed distilled spirits importers. The two groups involved, i.e., wholesalers who are designated to import by the distillers and those who are not, are functionally indistinguishable from a regulatory standpoint. Both have been licensed by the state to import and have thus already met the minimum standards required by the state for importers. The only distinction between the two groups is whether they are in the good graces of another private party. Nonetheless, A.B. 499 permits "designated" importers to import major brand liquor into the state while denying the same privilege to all other licensed importers.

This harsh line bears no relationship to an actual and legitimate legislative purpose.

This discrimination is so utterly devoid of any legitimate regulatory purpose that it cannot pass constitutional muster, even under the "rational basis" standard of review. The rational basis standard is not "toothless." *Trimble v. Gordon,* 430 U.S. 762, 767 (1977). In fact, in *Hornsby v. Allen, supra,* the rational basis standard was used to invalidate a similarly unfair liquor licensing statute. It is appropriate to invalidate a discrimination on the rational basis standard where, as here, no state regulatory interest has been found by the state courts.

Numerous courts have confronted the precise issue of whether statutory discrimination between franchisees (i.e., "designees") and non-franchisees violates equal protection. Applying the "rational basis" standard of review to statutes which prohibited non-franchisees from selling new cars, *Joyner v. Centre Motor Co.,* 192 Va. 627, 66 S.E.2d 469 (S. Ct. App. Va. 1951); *Nelsen v. Tilley,* 137 Neb. 327, 289 N.W. 388 (S. Ct. Neb. 1939); *Rebsamen Motor Co. v. Phillips,* 226 Ark. 146, 289 S.W.2d 170 (S. Ct. Ark. 1956), found that such statutes unconstitutionally bestowed a special privilege on one class of businessman. The statutes invalidated by these cases were functionally indistinguishable from § 23672: They all generally provided that a car dealer could not sell a new car of a particular brand unless he was designated as an authorized dealer of the brand-owner. Such legislation was intended to prevent independent dealers from buying surplus new cars from authorized dealers in other marketing areas and importing them into their own marketing area for sale at prices lower than those of authorized dealers. As noted in *Joyner,* the discrimination in such statutes had no regulatory purpose because it was impossible to maintain that the franchised dealers were in any way superior to the unenfranchised dealers in honesty or business ability.

F. Invalidity Under State Constitution

The state court noted that in view of its decision on federal antitrust and preemption grounds, it was not necessary for it to consider the Respondents' contentions that the statute was invalid under the California Constitution and indicated no view as to how it would resolve these issues. 108 Cal.App.3d 348, 362, 166 Cal.Rptr. 563, 573. In the event that this Court should disagree with the California court's preemption analysis, the proper disposition of this case would be to remand it to the state Court of Appeal for consideration of the other infirmities in the statute under the California State Constitution.[17]

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[17]Respondents attacked the statute under the California State constitutional provisions dealing with equal protection and due process. Respondents also contended that Art. XX, § 22 (quoted, p.1, *supra*) absolutely prohibits delegation by the state of regulatory power over liquor to private individuals. By providing that the state shall "have the exclusive right and power to regulate the importation" of liquor, the California Constitution prohibits any delegation, whether to individuals or municipalities of the power to regulate liquor importation. Recent California Supreme Court cases have found absolute prohibitions on delegations in much less specific language. *Bagley v. City of Manhattan Beach*, 18 Cal. 3d 22, 132 Cal.Rptr. 668, 553 P.2d 1140 (1976). The designation statute violates this absolute prohibition on delegation by granting to private parties the power to prevent an importer properly licensed by the state from importing goods which that importer has legally obtained in another state.

CONCLUSION

The judgment of the California Court of Appeal should be affirmed.

Respectfully submitted,

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